No. 105.

Brf. of Atty. Gen'l. (Penney & Pro

for Appellant.

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In the Supreme Court of the United States.

OCTOBER TERM, 1897.

THE UNITED STATES, APPELLANT, v. THE COMMISSIONERS OF THE SINKING Fund of the City of Louisville and the City of Louisville, Kentucky.	No. 105.

APPEAL FROM THE COURT OF CLAIMS.

APPELLANT'S BRIEF.

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THE COMMISSIONERS OF THE SINKING Fund of the City of Louisville and the City of Louisville, Kentucky. } No. 105.

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I.

STATEMENT OF THE CASE.

Between October 1, 1862, and July 6, 1872, the city of Louisville, Ky., held stock and bonds of the Louisville and Nashville Railroad Company, which company paid interest regularly on its bonds, and also from time to time cash dividends on its stock, retaining, however,

in each of the years 1865 to 1871, inclusive, an undistributed surplus. (Rec., 6.) The act of June 30, 1864, section 122 (13 Stats., 284), imposed a tax upon all the earnings of railroad companies, as follows:

> Any railroad * * * company indebted for any money for which bonds or other evidence of indebtedness have been issued, payable in one or more years after date, upon which interest is stipulated to be paid, or coupons representing the interest, or any such company that may have declared any dividend in scrip or money due and payable to its stockholders as part of the earnings, profits, income, or gains of such company, and all profits of such company carried to the account of any fund, or used for construction, shall be subject to and pay a duty of five per centum upon the amount of all such interest, or coupons, dividends, or profits, whenever the same shall be payable, and said companies are hereby authorized to deduct and withhold from all payments on account of any interest or coupons and dividends due and payable as aforesaid the duty of five per centum.

The act of July 13, 1866 (14 Stats., 138), amended the section from which the above is taken, but not in any way affecting the present case. Section 44 of the act of June 30, 1864 (13 Stats., 239), also amended by the act of July 13, 1866, and subsequently reenacted as Revised Statutes, section 3220, provided for the repayment of all taxes erroneously or illegally assessed or collected, but the act of June 6, 1872, section 44 (Rev. Stats., sec. 3228), limited the time for presenting applications for repayment to one year in the case of taxes already collected, and two years in the case of those to be thereafter

collected. The railroad company paid the taxes required by these statutes, and made the deductions from interest and cash dividends as authorized thereby, but in so doing it made no exception in the case of interest or dividends payable to public or municipal corporations. The fact that such taxes were paid upon the interest and dividends due the appellees, and that such deductions were made, was not known to the appellees until after the statutory time for applications for a refund of the taxes so deducted. (Rec., 6.)

By a resolution of the directors of November 16, 1867, the railroad company increased its capitalization by 40 per cent, distributing the new shares of stock among the stockholders in proportion to their holdings of the old stock. By a resolution of October 6, 1880, a further increase of capitalization was made to the extent of 100 per cent, the new shares of stock being distributed among the stockholders *pro rata* as before. (Rec., 6–7.)

On March 10, 1890, the appellees presented a petition to the House of Representatives, stating that taxes had been paid upon and deducted from the dividends declared upon the stock of the railroad company held by the city of Louisville, but making no mention of the stock dividends. (Rec., 7.) Subsequently the act of June 16, 1890 (26 Stats., 157), was passed, directing the Secretary of the Treasury and the collector of internal revenue to audit and adjust the appellees' claim "for internal-revenue taxes on dividends on shares of stock owned" by them "to the extent that such taxes were deducted

from any dividends due and payable to said board [of sinking fund commissioners], and to pass upon said claim and render judgment thereon in the same manner and with the same effect as if said claim had been presented and prosecuted within the time limited and fixed by law."

Under this act the appellees applied for a refund of $65,578.32 on account of taxes claimed to have been illegally exacted of the said city through the Louisville and Nashville Railroad, which amount was stated as follows:

1. Dividends (distributed)	$24,801.14
2. Dividends (undistributed or surplus)	21,721.29
3. Interest on bonds owned by city	815.30
4. Gross receipts	18,240.59
Total tax due	65,578.32

Evidence was presented of the 40 per cent increase in the stock of the railroad company in 1867–68, but it does not appear that any evidence as to the 100 per cent increase of stock in 1880 was presented at that time. (Rec., 7.)

This claim was duly audited and adjusted by the Commissioner of Internal Revenue, who allowed $24,801.14 on account of taxes paid by the Louisville and Nashville Railroad Company on dividends paid to the city of Louisville and $17,712.89 on account of taxes paid in 1865, 1866, and 1867 by the said railroad company on its undistributed surplus, the said sum of $17,712.89 being proportioned to the amount of stock issued to the city of Louisville out of the 40 per cent stock dividend above mentioned. He refused to allow the claim on account of

taxes paid on gross receipts and on interest and so much of the claim on account of taxes on undistributed surplus as concerned the taxes levied in 1868, 1869, 1870, and 1871. The action of the Commissioner was approved by the Secretary of the Treasury, and the First Comptroller did not question the correctness of the finding, but he reported that there was no appropriation out of which payment could be made. (Rec., 7–8.)

The amount allowed ($42,514.03) was reported to Congress by the Secretary of the Treasury February 14, 1891, as having been found due under the act of June 16, 1890, and as having remained unpaid for lack of an appropriation, but no statement of the items of the claim made or of those composing the amount allowed appears to have been made to Congress. (Rec., 9.) Subsequently the sum of $42,514.03 was appropriated by the act of March 3, 1891 (26 Stats., 862, 867), and was paid to the city of Louisville.

The act of February 25, 1893 (27 Stat., 447), directed the Secretary of the Treasury and the Commissioner of Internal Revenue to audit and adjust the claims of the appellees and others "for internal-revenue taxes collected on railroad dividends on stock, and on interest on railroad bonds owned" by them in certain companies "to the extent that such taxes were deducted from any dividends or interest due and payable to such boards respectively and which have not been heretofore refunded, * * * any statute of limitations to the contrary notwithstanding." The act also provided that "the amounts, when ascertained as aforesaid and not heretofore refunded,

shall be paid out of the permanent annual appropriation provided for similar claims allowed within the present fiscal year."

Under this act the appellees applied for a refund of $34,667.80 on account of taxes claimed to have been illegally exacted, which amount was stated as being partly composed of taxes deducted from interest on bonds and partly of "internal-revenue tax on undistributed dividends or surplus (which was afterwards, to wit, in April, 1881, reduced or converted into a scrip or stock dividend) collected as follows:"

October 31, 1868	$1,304.20
November 30, 1869	529.15
January 10, 1871	829.25
November 10, 1871	345.80
Total	3,008.40

Evidence was presented of the 100 per cent increase in the stock of the railroad company in 1880. The claim for the amounts stated to have been collected from the railroad company on account of taxes levied upon its undistributed surplus in 1868 to 1871 (amounting to $3,008.40 in all), had been included in the claim presented in 1890, but, as stated above, it had not been allowed. (Rec., 10–11.)

The Commissioner of Internal Revenue audited and adjusted this claim, and as incidental to such audit and adjustment he reexamined the claim allowed in 1891. He allowed the entire claim on account of taxes on interest on bonds ($31,659.40), and also that on account of taxes on surplus in 1868–71, which he found to amount to $3,248.51, making a total gross allowance of $34,907.91.

In consequence of the reexamination of the allowance of 1891 errors were found and corrected in all but three of the sixteen items then allowed on account of taxes on dividends, five of the allowances being increased and eight decreased, the aggregate result being a reduction of $221.34, or from $24,801.14 to $24,579.80. Errors were also found in the allowance of 1891 on account of taxes on surplus, which allowance was reduced by $3,327.55, or from $17,712.89 to $14,385.34, making a total reduction on both branches of the allowance of 1891 of $3,548.89, which, being subtracted from $34,907.91 allowed, left a net allowance of $31,359.02. (Rec., 11.)

The amount so allowed, having been approved by the Secretary of the Treasury, was certified by the Fifth Auditor to the First Comptroller, who held that the allowances on account of taxes on surplus were unwarranted, and he therefore deducted the sum of $17,633.85, leaving a balance of $13,725.17, for which sum he directed a draft to be issued to the city of Louisville. The amount so deducted ($17,633.85) was made up as follows (Rec., 11):

Amount allowed and paid in 1891 for taxes on surplus.	$17,712.89
Excess paid in 1891 for taxes on cash dividends.....	221.34
Total erroneous allowance paid in 1891.....	17,934.23
Net amount deducted by Commissioner (for errors in 1891) from allowance for taxes on interest.....	300.38
Balance of erroneous allowance to be deducted.	17,633.85

The appellees brought suit in the Court of Claims for the amount so deducted, and recovered judgment therefor, whereupon this appeal was taken. (Rec., 13–14.)

II.

ASSIGNMENTS OF ERROR.

The Court of Claims erred—

1. In holding that the appropriation of $42,514.02, made by the act of March 3, 1891 (26 Stats., 862, 867), for payment to the city of Louisville, Ky., of the amount found due by the Secretary of the Treasury and the Commissioner of Internal Revenue upon its claim, was such a determination of the exact amount due the said city that no portion thereof could be recovered back on account of a subsequently discovered mistake of fact or error of law, unless Congress authorized a reopening of the settlement.

2. In holding that the act of February 25, 1893, did not authorize, under any circumstances, the reopening and correction of the allowance made under the act of June 16, 1890, the amount of the said allowance having been paid under the act of March 3, 1891.

3. In holding that the First Comptroller was not entitled to deduct from the allowance made under the act of February 25, 1893, either the total sum of $17,633.85 deducted by him or the sum of $3,248.51 (part of the said sum of $17,633.85), which had been allowed for taxes on surplus not covered by the allowance and payment of 1891.

4. In entering judgment for the appellees in the sum of $17,633.43.

III.

BRIEF OF ARGUMENT.

The argument in behalf of the appellant may be summarized in the four following points, which will be considered in their order:

The payment of $42,514.02, made to the city of Louisville under the act of March 3, 1891, did not differ from ordinary Treasury payments as to the power of the officers of the Treasury to correct errors in the settlement and deduct any overpayments, made through mistake of fact or law, from any amounts subsequently found to be due to the said city.

Even if the payment made under the act of March 3, 1891, were of such a character that no portion thereof could be recovered back without subsequent authority of Congress, the act of February 25, 1893, authorized a reopening of the settlement and a deduction from the new allowance, in case any overpayments were found to have been made in the former settlement.

The settlement of 1891, having been reopened, in consequence of the presentation, under the act of 1893, of items disallowed in the former settlement, all errors therein, whether of fact or law, could be corrected and all overpayments deducted in the new settlement.

The deduction of $17,633.85 made by the Comptroller was properly made, as neither of the allowances made by the Commissioner of Internal Revenue in 1891 and 1893, respectively, for taxes paid on surplus earnings of the Louisville and Nashville Railroad Company, were authorized by the statutes under which the Commissioner was acting.

AS TO THE FIRST ASSIGNMENT OF ERROR.

The opinion of the court below shows that its judgment rests on the idea that the act of February 25, 1893, directing the adjustment and payment of certain claims of the appellees and others, did not authorize any reopening of the settlement, made in 1891, of a previous claim of the appellees, and also that the payment of the amount found due by that settlement, having been made by special appropriation, was itself of such a character as to prevent any reopening without special authority of Congress. Taking the latter point first, as the statute which it concerns was the first in point of time, it is submitted that—

THE PAYMENT OF $42,514.02, MADE TO THE CITY OF LOUISVILLE UNDER THE ACT OF MARCH 3, 1891, DID NOT DIFFER FROM ORDINARY TREASURY PAYMENTS AS TO THE POWER OF THE OFFICERS OF THE TREASURY TO CORRECT ERRORS IN THE SETTLEMENT AND DEDUCT ANY OVERPAYMENTS, MADE THROUGH MISTAKE OF FACT OR LAW, FROM ANY AMOUNTS SUBSEQUENTLY FOUND TO BE DUE TO THE SAID CITY.

As the appropriation made by the act of March 3, 1891, was necessitated by the fact that the act of June 16, 1890, carried no appropriation with it, the two acts may properly be considered together. They read as follows:

> *Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That the Secretary of the Treasury and the Commissioner of Internal Revenue be, and are

hereby, authorized and required to audit and adjust the claim of the board of the sinking fund commissioners of the city of Louisville, Kentucky, for internal-revenue taxes on dividends on shares of stock owned by said board for said city of Louisville, in the Louisville and Nashville Railroad Company, to the extent that such taxes were deducted from any dividends due and payable to said board, and to pass upon said claim, and render judgment thereon in the same manner and with the same effect as if said claim had been presented and prosecuted within the time limited and fixed by law. (26 Stats., 157.)

PAYMENT TO CITY OF LOUISVILLE, KENTUCKY.—For payment to the city of Louisville, Kentucky, the amount found due under the act of Congress approved June sixteenth, eighteen hundred and ninety, and reported to Congress in House Executive Document numbered two hundred and sixty, of the present session, forty-two thousand five hundred and fourteen dollars and three cents. (26 Stats., 867.)

Had the first act concluded with the words, "and the amount found to be due shall be paid out of any moneys in the Treasury not otherwise appropriated," or had it contained any other provision for an appropriation, and payment had been made thereunder, or had payment been made under any general appropriation, there can be no doubt that if any part of such payment had subsequently been discovered to have been erroneously made it could have been recovered in a suit at law (*United States* v. *Bank of the Metropolis*, 15 Pet., 377, 401), or set off in any suit subsequently brought by the city of Louisville (*McElrath* v. *United States*, 102 U. S., 426;

United States v. *Burchard*, 125 U. S., 176; *United States* v. *Stahl*, 151 U. S., 366), or deducted from any money of the city of Louisville that might subsequently be in possession of the United States (*Gratiot* v. *United States*, 15 Pet., 336; *United States* v. *Carr*, 132 U. S., 644; *Wisconsin Central R. R.* v. *United States*, 164 U. S., 190). Because the first act contained no provision for any appropriation, and no general appropriation was available, the item in the act of March 3, 1891, was required, but there is nothing in that act to show that the payment was to stand on any different basis from what it would have had if made under either a general appropriation or an appropriation clause in the first act. There is merely an appropriation of a certain sum "for payment to the city of Louisville" of "the amount found due" under a certain act and reported to Congress. There is no declaration that the amount "found due" is actually the amount due, or that the entire amount appropriated must be paid. Hence if, before the money was actually paid out, the accounting officers had discovered any errors in the settlement, so that the amount reported to Congress as having been "found due" was more than was actually due, they could certainly have corrected such errors and have limited the payment to what they held to be the amount justly due.

The present case is clearly distinguishable from that of *United States* v. *Jordan* (113 U. S., 418), cited by the court below. There a statute had expressly *directed* the Secretary of the Treasury "to remit, refund, and pay back * * * to the following-named citizens of Tennessee * * * the amount of taxes assessed upon

and collected from the said named persons contrary to [certain Treasury regulations]— * * * that is to say, * * * to Edward L. Jordan, two thousand two hundred and ninety dollars." It was held that Congress had undertaken "to determine not only what particular citizens of Tennessee by name should have relief, but also the exact amount which should be paid to each one of them," and that it had determined "that the amounts named were collected contrary to the provisions of the regulations," so that nothing was left to the Treasury to determine but the identity of the claimants with the persons named in the statute. A similar decision was made in *United States* v. *Price* (116 U. S., 43) upon another statute where the Secretary was "required" to pay specified sums to specified persons.

In the present case, however, the statute contained no direction to pay, nor any statement that the amount reported to Congress was the amount actually due, but merely appropriated money to enable the Treasury to pay the amount found due, or, in other words, to give the Treasury the same authority to pay that it would have had if the act authorizing the settlement had carried an appropriation with it. Of course, Congress presumed that the amount reported as due was correct, but if it had made an appropriation in the first instance it would equally have presumed that whatever amount might be ultimately found due the finding would be correct, and that none of the money would be paid on an erroneous or illegal allowance. In every appropriation that Congress makes for future expenses it necessarily presumes that the appropriation will be properly spent, and

only for expenses warranted by law. The only difference between the appropriation of March 3, 1891, and one that might have been made by the act of March 10, 1890, was that the one was subsequent to the settlement and the other would have preceded it. The presumption of the correctness of the settlement would have been precisely the same in either case.

Since, then, the officers of the Treasury could have retained a portion of the sum, appropriated March 3, 1891, in case, before payment, they found that the allowance was excessive, it is manifest that if errors were discovered after payment had been made, the excess payment over and above what was justly due could have been sued for, or set off in any suit by the city of Louisville, or deducted from any moneys of that city that might subsequently be in possession of the Treasury, precisely as if the payment had been made either under a general appropriation or one contained in the act authorizing a settlement. Hence, if the deductions made in 1893 by the Commissioner of Internal Revenue and the Comptroller were correct in themselves—a matter which will be considered below—they were properly made, and should not be recovered by the appellees.

In this particular connection it only remains to point out that there is nothing in the act of March 3, 1891, to show that Congress adopted the view taken by the Treasury officers in 1891 with regard to the legality of the claims covered by the settlement. The peculiarity of the settlement—the feature which gave rise to the Comptroller's action in 1893 and to the present suit—was that, although the act of June 16, 1890, had only authorized a claim

for taxes deducted from "dividends due and payable" on shares of stock, the appellees had made claim also for what they alleged to be their proportion of the taxes paid by the Louisville and Nashville Railroad Company on its undistributed surplus profits; and the greater part of this claim was allowed, on the theory that these surplus profits were ultimately distributed to the stockholders in the form of a stock dividend. The fallacy underlying this theory will be considered below, and it is enough at this point to submit (on the authority of *County of Logan* v. *United States*, 31 C. Cls. R., 23, now before this court on appeal) that the allowance for taxes on surplus was not warranted by the act of 1890, and to show that Congress did not intend by the appropriation of 1891 to declare that such allowance was warranted, or to legalize it in any way whatever.

The appropriation of 1891 defines the amount to be paid to the city of Louisville as "the amount found due under the act of June 16, 1890," and also as the amount reported in Executive Document No. 260, and it further states the amount as $42,514.03. Now, the only amount that was *really* found due under the act of June 16, 1890 (i. e., the only amount which was found due under the authority conferred by that act), was $24,801.14, the amount of taxes found to have been "deducted from any dividends due and payable," that being the only species of taxes which that act authorized to be found as due. Executive Document No. 260 (which is given in full in Finding VI as the communications transmitted to Congress), merely stated that after auditing the claim in pursuance of the act of June 16, 1890, the Secretary and the

Commissioner had found $42,514.03 to be due, but it did not state how the amount was made up. Moreover, the statement that $42,514.03 had been found "due," meaning that it had been found to be due under the terms of the act of June 16, 1890 (and the statement could have had no other conceivable meaning), was, legally speaking, false, as only $24,801.14 had been so fouund to be due. The appropriation act recites this false and misleading document as the only source of knowledge on the part of Congress as to the finding by the Secretary and the Commissioner, and it does not appear that Congress was made aware of their action in any other way. The very words of the appropriation act show that Congress was misled in the matter, just as much so as if the Secretary and the Commissioner had either erred by mistake of fact or had added to the amount of the claim by deliberate fraud.

To hold that the appropriation was a ratification or legalization of the unauthorized allowance is to read into the act such words as these:

> and the finding so made and reported is hereby recognized as properly made, within the true intent and meaning of the act of June 16, 1890.

Or these:

> to be paid to the said city of Louisville, whether the said amount was actually and legally due under the said act of June 16, 1890, or not.

Or these:

> and the finding so made and reported is adopted as if it had been made in pursuance of the act of June 16, 1890, and had been within its true intent and meaning.

The idea that Congress intended to waive errors or illegalities, and to pay the claim whether justly due under the act of June 16, 1890, or not, is supported by no evidence whatever, and certainly the existence of such an intention can not be presumed. The idea that Congress saw fit to ratify the illegal act of the Secretary and the Commissioner, and to treat it as if the act of June 16, 1890, had authorized an allowance on account of taxes on surplus earnings is equally untenable, because it is familiar law that a principal can not be held to have ratified the unauthorized acts of his agent unless he be shown to have had full knowledge of the facts. (*Bell* v. *Cunningham*, 3 Pet., 69, 81; *Owings* v. *Hull*, 9 Pet., 607, 629; *Billings* v. *Morrow*, 7 Cal., 171; *Field* v. *Small*, 17 Colo., 386; *Davis* v. *Talbot*, 137 Ind., 235; *Adams Express Co.* v. *Trego*, 35 Md., 47, 69; *Bannon* v. *Warfield*, 42 Md., 22, 42; *Harley* v. *Watson*, 92 Mich., 121; *Dowden* v. *Cryder*, 55 N. J., 329; *Trustees* v. *Bowman*, 136 N. Y., 521.) The only ground on which it could be contended that the appropriation of $42,514.03 was a ratification of the entire action of the Secretary and the Commissioner in finding that amount to be due is, that the position of Congress and these officers was somewhat analogous to that of a principal and his agents, but there being no evidence that Congress was aware of the real nature of the claim which these officers had seen fit to approve or of the fact that they had exceeded their authority—it being, in fact, evident that Congress was misled by the statements made to it—it is clear that one necessary condition of a ratification

(viz, full knowledge on the part of the principal) does not exist in this case, and hence that the theory of a ratification must fall.

To hold that Congress intended, in the appropriation item of March 3, 1891, to adopt the view taken by the Secretary and the Commissioner in applying the act of 1890, is as unreasonable as it would be to hold that a ratification was intended. These officers had no judicial authority to construe the law, and it appears that Congress was not informed as to the peculiar construction which they put upon it. It was held in *Savings Bank* v. *United States* (19 Wall., 227, 237), that the reenactment of a tax law in the same language as that of the earlier law did not indicate that Congress adopted the construction put by the Commissioner upon that language during a period of three years; and certainly in the present case there is even less reason for holding that his construction was adopted, as there is every indication that Congress did not know what that construction was.

Whatever, then, be the effect of the appropriation of 1891, it bears on its face the evidence of having been made in ignorance of the true state of the facts, and it furnishes no support for the contention that Congress, either then or at any other time, intended to pay to the claimants any sum whatever on account of taxes on surplus profits of the Louisville and Nashville Railroad Company.

It is to be observed that although the court below held (erroneously, as has been submitted), that the appropriation of 1891 was made in terms that required the money to be paid, without regard to errors in the allowance,

this decision was made solely on the doctrine of *United States* v. *Jordan*, and not on the ground that Congress knowingly approved the settlement as in accordance with the act of 1890. In point of fact, the same court decided on the same day (in *County of Logan et al.* v. *United States*, 31 C. Cls. R., 23, now before this court on appeal) that the act of February 25, 1893 (27 Stats., 477), authorizing the settlement of certain claims of the appellees and others "for internal-revenue taxes collected on railroad dividends on stock," and under which act Logan County had made precisely the same sort of claim as the appellees had made under the act of 1890, did not authorize any refund of taxes paid on undistributed surplus earnings, as the taxes were not such as could originally have been recovered under the acts of 1864 and 1866, and the subsequent stock dividend had not changed their character in any way. Had the court below held that the appropriation of 1891 settled the law as to the right to recover back taxes on surplus, this decision against such right would not have been made.

If, therefore, as has been submitted, the payment under the appropriation of 1891 did not differ from an ordinary Treasury payment, whatever part of it was erroneously allowed could at any time have been deducted from any moneys of the city of Louisville in the hands of the Treasury, and hence was properly deducted in the present instance, whether the act of February 25, 1893, authorized a reopening of the settlement under any circumstances or not, and the propriety of the deduction will be considered below without regard to whether there actually was any reopening or not.

AS TO THE SECOND ASSIGNMENT OF ERROR.

In regard to the act of 1893 it is submitted, in the first place:

EVEN IF THE PAYMENT MADE UNDER THE ACT OF MARCH 3, 1891, WERE OF SUCH A CHARACTER THAT NO PORTION THEREOF COULD BE RECOVERED BACK WITHOUT SUBSEQUENT AUTHORITY OF CONGRESS, THE ACT OF FEBRUARY 25, 1893, AUTHORIZED A REOPENING OF THE SETTLEMENT AT THE APPELLEES' INSTANCE, AND CONSEQUENTLY A DEDUCTION FROM THE NEW ALLOWANCE IN CASE ANY OVERPAYMENTS WERE FOUND TO HAVE BEEN MADE IN THE FORMER SETTLEMENT.

The act of 1893 reads as follows:

> *Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, be, and he is hereby, authorized and required to audit and adjust the claims of the sinking fund commissioners of the State of Kentucky, of Logan and Simpson counties in said State, of the city of Louisville, Kentucky, and of Sumner and Davidson counties, Tennessee, for internal-revenue taxes collected on railroad dividends on stock and on interest on railroad bonds owned by said counties and city, respectively, in the Louisville and Nashville Railroad Company and of said State for internal-revenue taxes collected and interest on railroad bonds of the railroad from Louisville to Lexington and on dividends on stock of said railroads owned by said State, and due and payable to said boards of sinking fund commissioners, respectively, and to said State, counties, and city, to the extent that such

taxes were deducted from any dividends or interest due and payable to such boards, respectively, and which have not been heretofore refunded; and for this purpose, any statute of limitation to the contrary notwithstanding, sections nine hundred and eighty-nine, thirty-two hundred and twenty, thirty-two hundred and twenty-six, thirty-two hundred and twenty-seven, and thirty-two hundred and twenty-eight of the United States Revised Statutes are hereby made applicable and available with the force and effect as if protest and demand for payment had been made within the time prescribed by said sections; and the amounts when ascertained as aforesaid, and not heretofore refunded, shall be paid out of the permanent annual appropriation provided for similar claims allowed within the present fiscal year. (27 Stats., 477.)

As regards these appellees, the above act differs from that of June 16, 1890 (26 Stats., 157), in that they had made no application for refund before that act was passed, whereas, as Congress knew, when the act of 1893 was passed, the appellees had already made a claim and received an allowance, which had been paid by a special appropriation, on one of the matters (viz, taxes on dividends), for which the act of 1893 authorized claims to be presented, audited, and paid. Hence, in regard to these appellees, three things were possible:

First, that claims should be presented for taxes refunded on the former application.

Second, that claims should be presented for items disallowed on the former application.

Third, that errors should have been made in the former allowance.

Congress must be presumed to have had these three contingencies in mind, because they would naturally suggest themselves to any man of ordinary intelligence when called upon to consider the matter.

The first contingency was expressly provided for by limiting the allowance and payment to claims for taxes which had not been already refunded, and this limitation necessitated a careful reexamination of every item of the former allowance, in order to ascertain positively whether any portion of the second claim for refund had been included in the prior allowance and payment.

The second contingency was dealt with by not forbidding the presentation a second time of items previously disallowed, and it was evident from the first that the presentation of any such items necessitated a reconsideration of the previous decision (or "judgment," as the act of 1890 called it) whether such decision were ultimately adhered to or not; and if such decision were departed from, that would involve a setting aside of the previous settlement.

The Commissioner of Internal Revenue being required to reopen the old settlement in case the second contingency occurred, and no restriction being placed upon his power to change the former allowances, it is clear that if the second contingency occurred, and the settlement were reopened in consequence, any errors in the previous settlement could be corrected, or, in other words, the third contingency might also be dealt with.

Of course Congress *might* have provided that the settlement should only be reopened for the benefit of the appellees, and that no change therefrom for the benefit of the

appellant should be made, just as Congress *might* have forbidden the consideration of items previously disallowed, and thus prevented a possibility of a reopening for either side; but it did not see fit to do so, and it would have been most unfair to the United States if it had. Without any such restriction of what might be done under a reopening, it is clear that if the reopening took place anything might be done which would be permissible in any case of reopening. A settlement once made must either remain closed or be reopened; it is inconceivable that it should be reopened as to one party, while remaining closed as to the other, unless in a case where Congress has expressly authorized the existence of such an anomalous state of affairs.

In *McElrath* v. *United States* (102 U. S., 426, 441) this court expressly laid down the doctrine that if a settlement is reopened for the benefit of one side, the other side also can claim the benefit of such reopening. The opinion reads as follows:

> Had the appellant rested upon the settlement of his account by the proper officers of the Government his right to invoke the general rule [of the finality of such settlements] would have been entitled to more consideration than it can now receive. * * * This suit itself invites the court to go behind that settlement, to reexamine all the questions arising out of the appellant's claim for full pay and allowances, and to correct the error which he insists was committed to his prejudice by the accounting officers of the Government. The Government * * * meets him upon his own chosen ground, and, insisting that its officers, misapprehending the law, paid to

> him out of the Treasury money to which he was not legally entitled, asks, as we think it may rightfully do, judgment for the amount thus improperly paid to him.

The case just cited involved the reopening of a settlement by means of a proceeding in court, but the doctrine obviously applies as well where the settlement is reopened in the Treasury itself, by special authority of Congress. No argument that applies in the case of a reopening of the former sort can fail of application in the latter case also.

It follows, then, that the court below was clearly in error when it held that "the statute [of 1893] as it stands expresses no intent to disturb what has been done, and no such intent can be read into it where there is no such implication." (Rec., 13.) If the previous settlement had not been one of disallowance as well as of allowance, or if the statute had forbidden the presentation of items previously disallowed, then the statement just quoted would have been correct, but the court below has overlooked the fact that, under the circumstances of the case, the act permitted a reopening, even though it did not require it.

Even conceding, for the sake of the argument, that the doctrine of *United States* v. *Jordan* (113 U. S., 418), referred to by the court below, would have prevented any part of the payment of 1891 from being recovered back without further authority from Congress, yet that doctrine can have no application here, because Congress did, by the act of 1893, authorize a reopening of the settlement.

In so doing, moreover, it did not take away any property of the appellees, because the act of 1893 granted them a privilege, which they could use or not as they chose, and hence whatever conditions its terms involved could properly be imposed.

The error into which the court below fell was manifestly due to its failure to distinguish between a reopening of the old settlement by the officers of the Treasury of their own motion, and a reopening on the motion of the appellees, in consequence of the renewed presentation of claims disallowed on that settlement. The former was not authorized by the act of 1893, but the latter was clearly permitted, for the old settlement being of a claim for taxes on dividends, and the presentation of precisely similar claims being authorized by the act of 1893, it would have required express language to forbid the presentation of items previously presented and rejected. In fact the very prohibition of the payment of taxes previously refunded would seem, on the doctrine of *expressio unius est exclusio alterius*, to be a positive warrant, both for the presentation and the allowance (if they were sufficiently proved), of items previously presented and rejected. Of course such a reopening might not have taken place at all; it depended on the appellees as to whether it should take place or not; but if it did once take place, it would have necessarily to be a complete reopening, which might result in a reduction of the allowance as to some items as well as an increase as to others, or even without any increase whatever.

Coming then to what was actually done under the act of 1893, it is further submitted:

THE SETTLEMENT OF 1891 HAVING BEEN REOPENED, IN CONSEQUENCE OF THE PRESENTATION, UNDER THE ACT OF 1893, OF ITEMS DISALLOWED IN THE FORMER SETTLEMENT, ALL ERRORS THEREIN, WHETHER OF FACT OR LAW, COULD BE CORRECTED, AND ALL OVERPAYMENTS DEDUCTED IN THE NEW SETTLEMENT.

The act of 1893 having contained no prohibition of the presentation of claims previously disallowed, the appellees presented a claim not merely for taxes paid on interest on bonds (a claim which was not presentable under the act of 1891), but also for the following items:

To internal-revenue tax on undistributed dividends or surplus (which was afterwards, to wit, in April, 1881, reduced or converted into a scrip or stock dividend) collected as follows:

October 31, 1868	$1,304.20
November 30, 1869	529.15
January 10, 1871	829.25
November 10, 1871	345.80
Total	3,008.40

These items had formed part of the claim presented under the act of 1890 (Rec., p. 11), but had been disallowed by the Commissioner of Internal Revenue, apparently because of lack of evidence of the issue of any stock dividend after that declared in 1867 and issued in 1868. To remedy this defect, the claimants, in 1893, presented evidence of the declaration of a stock dividend of 100 per cent in 1880, and of the issue of stock in consequence thereof.

Had the appellees not seen fit to make claim for these items, then (supposing, for the sake of the argument, that no part of the payment of 1891 could be recovered back without a reopening by authority of Congress,) the settlement of 1891 could not have been reopened; for the mere reexamination of the items of that settlement, required by the act of 1893, in order to prevent any allowance of taxes already refunded, could not strictly be called a reopening, and there was nothing in the act to authorize the Commissioner of Internal Revenue to reopen the settlement of his own motion without a request from the appellees. The appellees, however, by presenting again these previously disallowed items, demanded a reconsideration of the previous decision, and a setting aside of the old settlement which had excluded these items. Accordingly the Commissioner not merely proceeded to compare the new claim with the old allowance, so as to avoid duplication of items, but he also received the new evidence presented in support of the previously rejected items; and, further, the old settlement having been opened on the appellees' demand, the reopening could not be confined to the particular items as to which reopening was asked, and hence the correctness of every item of the old settlement was inquired into.

The allowances in the old settlement had been $17,712.89 on account of taxes paid in 1865, 1866, and 1867 on the undistributed surplus earnings of the Louisville and Nashville Railroad, which taxes the Commissioner had treated as having been deducted from the stock dividend made in 1868, and $24,801.14 on account of

taxes paid on cash dividends, making $42,514.03 in all. (Rec., 7–8.) The result of the reopening and reexamination was that out of the sixteen items allowed in 1891 on account of taxes on dividends (semiannual dividends for eight years) five were increased, eight decreased, and only three remained unchanged, while the allowance for taxes on surplus, treated as stock dividend, was also found to have been excessive and was reduced by $3,327.55. The previously rejected items of taxes paid on surplus earnings in 1868–1871, regarded as taxes deducted from the stock dividend of 1880, were allowed on the new evidence presented in support of them, and were even increased, $3,248.57 being found to be due on this account instead of $3,008.40, as claimed. In spite, however, of this new allowance and of the increase of some of the old items, the reductions were such that the ultimate effect of the reopening was that $300.38 was found to have been paid the appellees on account of taxes on dividends, both cash and stock, in excess of what the Commissioner held to have been really due both on the items originally allowed and on those originally rejected but now reconsidered and allowed. This sum of $300.38 was accordingly deducted from the sum of $31,659.40, found due for taxes on interest, leaving a balance of $31,359.02. (Rec., 11.)

The Commissioner not merely reopened the former settlement, allowing items previously rejected and changing the allowances in all but three of the items previously allowed, but he treated the claims presented in 1890 and 1893 as one account, on which a partial payment had been

made. He accordingly reported to the Secretary of the Treasury as follows (Rec., 11):

> The total amount so withheld from said city [Louisville] on account of tax on the coupons of said bonds is found to be thirty-one thousand six hundred and fifty-nine dollars and forty cents ($31,659.40), and the total share of taxes on dividends and surplus borne by the city is found to be forty-two thousand two hundred and thirteen dollars and fifty-seven cents ($42,213.57), making an aggregate of seventy-three thousand eight hundred and seventy-two dollars and ninety-seven cents ($73,872.97). Of this aggregate the sum of forty-two thousand five hundred and thirteen dollars and ninety-five cents ($42,513.95) has been refunded (see Fifth Auditor's report No. 58114), which leaves thirty-one thousand three hundred and fifty-nine dollars and two cents ($31,359.02) to be refunded. I propose to allow the claim for this amount.

This action of the Commissioner in deducting for errors in the previous allowance $3,548.89 (i. e., $221.34 from allowance for taxes on dividends, and $3,327.55 from that for taxes on surplus) from the allowance made on the new claim was not objected to by the appellees, who sued merely for the further amount of $17,633.85, subsequently deducted by the Comptroller for reasons which will be considered below; and hence the court below has only given judgment for this amount, and has said nothing directly in the opinion as to the legality or illegality of the Commissioner's action. On the theory of the court below, however, the Commissioner had no right either to allow items disallowed on the old settlement or to alter previous allowances, and

suit should have been brought for $17,934.23, being the total amount of all deductions made either by the Commissioner or the Comptroller from the amount found due on the items not involved in the old settlement, viz, those for taxes paid on interest on bonds. It is submitted, however, on the part of the appellant, that the Commissioner was authorized, under the act of February 25, 1893, not merely to correct mistakes of fact in the old settlement, but also, that settlement having been reopened at the appellees' instance, to correct whatever he might consider errors of law therein. The fact that he did not himself see errors of law therein is immaterial.

AS TO THE THIRD AND FOURTH ASSIGNMENTS OF ERROR.

In regard to the deduction made by the Comptroller over and above those made by the Commissioner, it is submitted:

THE DEDUCTION OF $17,633.85, MADE BY THE COMPTROLLER, WAS PROPERLY MADE, AS NEITHER OF THE ALLOWANCES MADE BY THE COMMISSIONER OF INTERNAL REVENUE IN 1891 AND 1893, RESPECTIVELY, FOR TAXES PAID ON SURPLUS EARNINGS OF THE LOUISVILLE AND NASHVILLE RAILROAD COMPANY, WERE AUTHORIZED BY THE STATUTES UNDER WHICH THE COMMISSIONER WAS ACTING.

The Commissioner had confined himself to correcting errors of fact in the old settlement, and to reconsidering the former disallowance of the items for taxes on surplus in 1868–1871. When, however, the allowance reached the

Comptroller, he considered that nothing ought at any time to have been allowed on account of taxes on surplus, and therefore deducted $17,633.85 on that account. This amount is stated in the findings as made up as follows:

Amount allowed and paid in 1891 for taxes on surplus..	$17,712.89
Excess paid in 1891 for taxes on cash dividends.....	221.34
Total erroneous allowance paid in 1891.....	17,934.23
Net amount deducted by Commissioner (for errors in 1891) from allowance for taxes on interest.....	300.38
Balance of erroneous allowance to be deducted.	17,633.85

It can also, and perhaps better, be stated as follows:

Erroneous allowance of 1891 for taxes on surplus in 1865–1867.....	$17,712.89
Deducted by Commissioner in 1893 for errors of computation in this allowance.....	3,327.55
Net allowance of 1891 for taxes on surplus.....	14,385.34
Erroneous allowance of 1893 for taxes on surplus in 1868–1871.....	3,248.51
Total erroneous allowance deducted by Comptroller.....	17,633.85

This deduction of $17,633.85 is the cause of the present suit; and in connection with the present branch of the argument, three points need to be considered in regard thereto, viz:

1. Whether the allowances for taxes on surplus had been authorized by law.

2. Whether a deduction on account of errors of law in a previous settlement could properly be made in the Treasury Department.

3. Whether the Comptroller could properly make a deduction from an allowance of this character.

(1.)

Whether the allowances for taxes on surplus had been authorized by law.

As to this point it is submitted:

THE ACTS OF JUNE 16, 1890, AND FEBRUARY 25, 1893, DID NOT AUTHORIZE THE ALLOWANCE OF ANY CLAIM ON ACCOUNT OF TAXES PAID BY THE LOUISVILLE AND NASHVILLE RAILROAD COMPANY UPON ITS UNDISTRIBUTED SURPLUS, AND THE FACT THAT IN 1867 AND IN 1880 THE SAID COMPANY INCREASED ITS CAPITALIZATION BY ISSUING ADDITIONAL CERTIFICATES OF STOCK TO SHAREHOLDERS IS WHOLLY IMMATERIAL.

The facts of the case are very simple. The act of June 30, 1864, § 122 (13 Stats., 284), provided—

> That any railroad * * * company indebted for any money for which bonds or other evidence of indebtedness have been issued, payable in one or more years after date, upon which interest is stipulated to be paid, or coupons representing the interest, or any such company that may have declared any dividend in scrip or money due and payable to its stockholders as part of the earnings, profits, income, or gains of such company, and all profits of such company carried to the account of any fund, or used for construction, shall be subject to and pay a duty of five per centum upon the amount of all such interest or coupons, dividends or profits, whenever the same shall be payable, and said companies are hereby authorized to deduct and withhold from all payments on account of any interest or coupons and dividends due and payable as aforesaid the duty of five per centum, * * * and a list or return shall be made and

> rendered to the assessor or assistant assessor in duplicate, and one of said lists or returns shall be transmitted and the duty paid to the Commissioner of Internal Revenue within thirty days after the time when said interest, coupons, or dividends become due and payable, and as often as every six months.

Section 103 of the same act (13 Stats., 275) imposed a tax on the gross receipts of railroad companies, and hence those companies paid four taxes, viz, on gross receipts, on interest on bonds, on dividends paid, and on undistributed earnings. Only the taxes on interest and on dividends were or could be deducted from the payments made by the companies; the other taxes were necessarily paid by the companies themselves, as distinguished from their stockholders or bondholders.

The amendatory act of July 13, 1866 (14 Stats., 138), did not change this section as to any matter involved in the present case, so that the section above quoted contains all of the internal-revenue law with which we are now concerned. It is in evidence that the Louisville and Nashville Railroad Company paid taxes, under the above laws, upon the dividends on its stock, including that held by the appellees, and deducted such taxes from the amount of the dividends, but, as regards the stock held by the appellees, such payment and deduction was unlawful, as decided in *United States* v. *Railroad Co.* (17 Wall., 322). The time having elapsed within which the appellees could, under the laws then in force, apply for a refund of these taxes, the acts of 1890 and 1893 were passed, and hence the object of those acts was to enable the claims of the appellees to be audited and adjusted "in the same

manner and with the same effect as if this claim had been presented and prosecuted within the time limited and fixed by law."

This being so, the claims may be regarded solely with reference to the appellees' rights under the act of 1864, just as if claim had been made when it ought originally to have been made.

In presenting their claim to the Commissioner of Internal Revenue under the acts of 1890, the Louisville sinking fund commissioners included all the four kinds of taxes which the Louisville and Nashville Railroad Company had been called upon to pay, viz (Rec., 7):

1. Dividends (distributed)	$24,801.14
2. Dividends (undistributed or surplus)	21,721.29
3. Interest on bonds owned by city	815.30
4. Gross receipts	18,240.59
Total tax due	65,578.32

The first item, cash dividends actually distributed, was clearly within the act of 1890, which authorized a claim for taxes "deducted from any dividends due and payable," but as that act did not authorize a claim for anything else, the third and fourth items were as clearly outside its operation, and hence were at once rejected by the Commissioner. (Rec., 8). As the taxes on surplus, covered by the second item, had never been deducted from any payments made to the appellees nor were referred to in the act of 1890, this item also should have been rejected, but it appeared that a stock dividend of 40 per cent had been declared in 1867 and distributed in 1868, and it was urged that the surplus had been converted into this stock dividend, which had therefore been

diminished to the extent of the taxes collected on the surplus. This contention prevailed with the Commissioner, and the allowance covered $17,712.89, on account of taxes paid in 1865, 1866, and 1867 on so much of the undistributed surplus as was in proportion to the amount of stock held by the appellees. (Rec., 7.)

This part of the allowance was wholly illegal, because no such allowance could have been made under section 44 of the act of June 30, 1864 (Rev. Stat., sec. 3220), and the act of June 16, 1890, merely authorized such an allowance for taxes on dividends as could have been made had the application been made in due time. This precise point has been absolutely decided by the Court of Claims in *County of Logan* v. *United States* (31 C. Cls. R., 23), now before this court on appeal (October term, 1897, No. 167). That decision was rendered in regard to the act of February 25, 1893, but as the provisions of the two acts in regard to taxes on dividends are in substance exactly the same, the decision is equally applicable to cases under either act. The court's line of argument was as follows:

> It should be premised that the act of 1893 is simply remedial. It does not create a claim or declare a right. All that it does, or assumes to do, is to relieve the claim from the bar of a statute of limitations. It does not empower the Commissioner to refund money which he could not have refunded if the claimant had applied to him in due time and the act of 1893 had never been passed. The exemption of the claimant and the right to a refund must be determined by the act of 1864, under authority of which the tax was imposed and, legally

or illegally, collected. * * * The ground of the appeal to Congress was that these municipalities were ignorant of the fact that a tax had been deducted from their dividends and of the law as subsequently declared by the Supreme Court in *United States* v. *Railroad Company* (17 Wallace, 322). But if the municipalities had known of the payment of the tax on these reserved profits or "undistributed sums" and of the law as subsequently declared by the Supreme Court of what would it avail them? They could not have asked for a refund at the time when the tax was paid, because the profits had not been turned into a dividend by the company, but had been retained by a corporate body for corporate purposes. They could not have asked for a refund in 1867, when the stock dividend was issued, because more than two years had elapsed since the payment of the tax, and no tax was then paid on the scrip dividend. Furthermore, had there been no statute of limitations the Commissioner of Internal Revenue could not in 1865 or in 1867 have made a refund, for the money was legally collected when the tax was paid, and the tax could not have been invalidated, in whole or in part, by an act of the company done long after the collection. Neither could the Commissioner have held that the distribution of a stock dividend in 1867 was in legal effect the distribution of a cash dividend in 1865. * * * The crucial question in this case is, *Who was the owner of the property when the tax was collected?* and the controlling fact in the case is *that the undistributed profits of the company were not the property of the claimant when the tax on them was paid.* It was not the claimants' property that was taxed; and there is no law which authorizes a refund to one person of a tax imposed on another person's

property, or which authorizes the refund of a tax which was legally imposed and collectible when it was paid.

For an elaboration of that argument the court is referred to the whole opinion of the Court of Claims in the Logan County Case, as printed in the record of that case on appeal (No. 167), and if further argument be needed to sustain the application of that decision to this present case it will be found in the following pages.

The only claim which the Secretary and the Commissioner were authorized to audit and adjust was one "for taxes on dividends on shares of stock * * * to the extent that such taxes were *deducted* from dividends due and payable." Under the revenue acts of 1864 and 1866 dividends "in scrip or money" were taxable, and the Commissioner treated the claim on account of taxes on surplus in 1865–1867 as a claim on account of taxes on scrip dividends, but to authorize an allowance for such taxes it was necessary that the railroad company should have done three things:

(1) Declared dividends in scrip in those years.

(2) Paid taxes thereon.

(3) Deducted those taxes from the dividends.

The reason why Congress in the remedial acts of 1890 and 1893 required that the taxes should have been "deducted" and not merely paid is clear. The most recent decisions hold that a tax on dividends is a tax on the net earnings of a corporation, and not a tax on the stockholders (*Barnes* v. *The Railroads*, 17 Wall., 294; *Railroad Co.* v. *Collector*, 100 U. S., 595; *United States*

v. *Erie Railway Co.*, 106 id., 327; *Memphis and Charleston Railroad Co.* v. *United States*, 108 id., 228), and it was only on the ground that the corporation was entitled to recoup itself out of the dividends that it was held that the act of 1864 did not authorize a tax on dividends of stock owned by municipal corporations (*Bailey* v. *Railroad Company*, 22 Wall., 604). The deduction from the dividend is clearly all that entitles a municipality to recover the tax paid on the dividends on its stock. If, as to any dividend, there was no deduction, there can be no recovery.

Whether or not the stock dividend declared in 1867 and issued in 1868 was a "dividend in scrip" within the meaning of the act is unimportant for the purposes of the present argument; but, assuming that the appellees were right in contending that it was, the fact remains that no such "dividend in scrip" was declared in 1865 or 1866, but only in 1867. Hence, while the first of the three essential conditions just mentioned existed with regard to the claim based on the taxes of 1867, it did not exist with regard to those based on the taxes of 1865 and 1866, and of course the other two essential conditions did not exist with regard to those two claims.

Coming to the second condition, the record does not show that any tax was paid by the railroad company, even upon the stock dividend declared in 1867. In other words, neither the second nor the third condition existed in regard to this stock dividend.

The whole claim for a refund of taxes paid on stock dividends, therefore, falls to the ground, for the very sufficient reason that no such taxes were paid; and hence,

as already stated, the allowance of such a claim was wholly without warrant of law.

To prevent misunderstanding, it may be as well to state at this point that had any stock dividends issued by the railroad company been taxed, the appellees' share in them would have been exempt under *United States* v. *Railroad Company* (17 Wall., 322), *Stockdale* v. *Insurance Companies* (20 id., 323, 330), and *Bailey* v. *Railroad Company* (22 id., 604, 632), the doctrine being, as stated in the case last cited, that—

> Liabilities of the kind [for taxes on dividends] do not attach to the company in cases where the stockholder is exempt by law from such an exaction, as the same section of the act provides that the company in such a case is authorized to deduct and withhold the amount of the tax from all payments on account of such interest or coupons and dividends, which can not have any application in a case where the stockholder is by law exempt from any such exaction.

As stated in the last two cases cited above, this doctrine holds, whether the tax levied under section 122 of the act of 1864 be regarded as a tax on the income of stockholders and bondholders, as was held in the earlier cases (*Haight* v. *Railroad Co.*, 6 Wall., 15; *Railroad Co.* v. *Jackson*, 7 id., 262, and *United States* v. *Railroad Co.*, 17 id., 322), or as a tax on the net earnings of the corporation, as laid down in *Barnes* v. *The Railroads* (17 Wall., 294), *Railroad Co.* v. *Collector* (100 U. S., 595), *United States* v. *Erie Railway Co.* (106 id., 327), and *Memphis and Charleston Railroad Co.* v. *United States* (108 id., 228).

In the present case, however, there were, as already stated, no stock dividends which were taxed, and it is clear that the claim was not in reality for any taxes paid on "dividends in scrip" or "stock dividends" issued to the appellees at all, but for a certain proportion of the taxes paid on that part of the profits which was not distributed in dividends, but constituted what the acts of 1864 and 1866 call "profits carried to the account of any fund or used for construction." These profits were, however, a very different thing from the stock dividends, and the taxes paid upon them were in no sense taxes upon any stock dividend.

It is familiar doctrine that the property of a corporation belongs to it and not to its stockholders, and this is no less true of its undistributed net earnings than of any other kind of property. (*Minot* v. *Paine*, 99 Mass., 101, 106; *Gibbons* v. *Mahon*, 136 U. S., 549, 558.) This doctrine was recognized by the act of 1864 itself, for while that act authorized corporations to deduct from the amounts paid out as interest and cash dividends the amount of the taxes on such interest and dividends, no such deduction was possible in the case of profits carried to surplus account, because the company retained these profits, so that they never came into the possession of the stockholders. Whether, as the earlier cases held, the tax on interest and dividends was an income tax on bondholders and stockholders or not, it is perfectly clear that the tax on undistributed profits, whether carried to surplus account or used in construction, was, like the tax on gross earnings, a tax on the corporation and not on its stockholders.

The declaration of a stock dividend in 1867 in no way altered the character of the previous surplus earnings. They were not distributed among the stockholders, but remained the property of the corporation precisely as they had been before.

> Stock dividends never diminish or interfere with the property of a corporation. * * * After a stock dividend a corporation had just as much property as it had before. It is just as solvent and just as capable of meeting all the demands upon it. After such a dividend the aggregate of the stockholders own no more interest in the corporation than before. The whole number of shares before the stock dividend represented the whole property of the corporation, and after the dividend they represent that, and no more. *A stock dividend does not distribute property*, but simply dilutes the shares as they existed before. (*Williams* v. *Western Union Tel. Co.*, 93 N. Y., 162, 189.)

The same doctrine is maintained in 2 Beach on Private Corporations, section 477; title, "Dividends," 5 Am. and Eng. Encyc. of Law, 744a, 744b, and clearly underlies the decision in *Minot* v. *Paine* (99 Mass., 101, 107), where the court said:

> When they [the directors] increase the number of shares, each share of all the stock in the corporation is in its nature capital. The new shares take their place among the old ones, and each of the old shares thereby *becomes a less proportion of the whole stock than it was before*, and is entitled to a less proportion of dividends declared than it was before.

As has been well said by Mr. Taylor in his Law of Corporations, § 801:

> Usually to speak of a "stock dividend" involves in reality a contradiction in terms. A dividend is a distribution of profits. But when a corporation has accumulated profits and declares a "stock dividend," just what the corporation does not do is to declare a dividend. A "stock dividend" is no dividend, no real distribution, either of profits or capital, but merely an increase in the number of shares into which the capital is divided. * * * Should [a bank] issue another share of stock to each shareholder for every share already held by him, it would not distribute a cent. Where, before such issue or "stock dividend," if one so choose to call it, the holder of one share owns one four-thousandth of the entire property, after such issue he will own two eight-thousandths.

In 1868 the city of Louisville owned 40 per cent more shares in the stock of the Louisville and Nashville Railroad Company than it did before, but as the holding of every other stockholder was similarly increased, the city's interest in the undistributed surplus earnings was not changed. Each share represented less of the total surplus than it did before in proportion to the extent to which the stock had been "watered," but the total interest of each stockholder in the surplus remained the same. The surplus earnings remained the property of the corporation after the new stock was issued, just as they had been previously. The corporation, not the stockholders, paid the taxes on each year's surplus earnings as they were carried to surplus account or used for construction, and the stockholders' income was in no way diminished thereby.

It is true that each share of stock represented less property than if the taxes had not been levied and paid, but the same is true as regards the taxes on gross earnings. The act of 1890 did not authorize a claim on account of the diminution of the corporate assets by taxation, but merely a claim for the taxes "deducted from dividends due and payable." The taxes on undistributed surplus were never so deducted, either at the time they were paid or at any subsequent time, and hence were not within the contemplation of the act of 1890.

Even if the appellees' theory that the stock dividend declared in 1867 was a dividend or distribution of earnings theretofore undistributed could possibly stand, this would not give them any right to a refund of the taxes that had been paid upon those earnings. In *Bailey* v. *Railroad Company* (106 U. S., 109) a company had issued to its stockholders certificates that a certain portion of the earnings had been expended in constructing and equipping the road, purchasing property, etc., which certificates were eventually to be either paid out of future earnings or converted into stock at the option of the company. It was held that the certificates so issued constituted a dividend in scrip, but that except in so far as such dividend was declared as of the earnings of the current year, and paid as such, it was not taxable at all, because, as to earnings of prior years, it was declared as of earnings upon which taxes either had been paid or (if the earnings antedated the tax law) had never been due. A dividend of profits which had previously been taxed was not, said the court, subject to taxation as a dividend. In the present case the so-called stock dividend differed to some extent from

the dividend in scrip passed upon in *Bailey* v. *United States*, in that it possessed less of the real character of a dividend, but even if it had been of the same character it would not have been taxable, because the surplus profits which it would have represented had themselves been taxed, including those of 1867. The only taxes which the act of 1890 authorized the Commissioner of Internal Revenue to consider were such as had actually been deducted from dividends *due and payable*, and this because until dividends became *due and payable* they were not taxable under the act of 1864, and therefore no tax could have been deducted from them. Hence, even if the stock dividend of 1868 could possibly be regarded as representing the surplus profits of prior years, the taxes upon such profits, having been paid before that dividend became due and payable, could not possibly have been paid upon it or deducted from it, and could not possibly come within the act of 1890.

The appellees' contention that the act of 1890 authorized the Commissioner to allow a claim for taxes on the railroad company's surplus, because the company had subsequently declared a stock dividend, applies equally well to the taxes on gross receipts. Had the gross receipts not been taxed, the net surplus would have been greater, and in consequence, according to the claimants' theory, the stock dividend would have been greater. In point of fact the appellees took this view at first and presented a claim for $18,240.59 for taxes on gross receipts. (Rec., p. 7.) Their right to recover this amount was precisely the same as their right to recover for taxes on surplus.

Every argument that could be brought to support a claim on the latter account applies equally well to the former, and how the Commissioner could have rejected the former while allowing the latter is inexplicable on any other theory than that of a determination to "draw the line somewhere."

The appellees' contention that the act of 1890 contemplated a claim for taxes on surplus profits afterwards "converted" into a stock dividend is, moreover, untenable on account of the nature and operation of the taxes themselves, as will be readily seen when the object of the act of 1890 and the reason for its passage are considered. The reason for the passage of the act was that the United States had no right to tax the revenues of a municipal corporation by the indirect process of authorizing a railroad company to deduct the taxes levied upon the dividends paid by it from such portion of those dividends as accrued to a municipal corporation as a stockholder; and the object of the act was to put the city of Louisville in the same position that it would have held had the dividends on its stock been excepted originally from the operation of the tax law, as they ought to have been. Had they been so excepted, the city would have received from year to year the same dividend that it did receive plus the amount of the tax which was deducted from it. The total amount of the taxes so deducted constituted the amount by which the revenues of the city had been diminished—the measure of its damages—and the repayment of this tax would put the city back precisely where it would have stood had the

tax law contained the proper exception in favor of municipal corporations, saving only as to the deprivation of its use of the money in the meantime.

Neither this reason nor this object exist in regard to a payment to the city of a part of the taxes upon the railroad company's surplus earnings proportionate to the amount of stock held by the city. Such a payment would not put the city back where it would have stood if no tax had been levied on a portion of the surplus earnings of a company proportionate to the amount of its stock held by municipal corporations. If such an exception from the operation of the tax had been made, the benefit would not have gone to the city, but would have remained with the company, and this simply because the surplus earnings did not go to the city, but remained with the company. Now, conceding for a moment the appellees' wholly untenable propositions that the surplus earnings of a number of years were ultimately "converted into" a stock dividend, and that that stock dividend would have been larger or more valuable had no taxes been levied on a portion of the surplus earnings proportionate to the amount of stock held by the city, what would have been the result? The exemption of any portion of the surplus earnings from taxation would have simply increased the amount of those earnings in the company's treasury, and applicable to the purchase of additional property, the improvement of what it already had, or the extension of its business. Granting that the stock dividend would have been larger or more valuable on that account, the increase would not have inured to the benefit of the city alone, but to that of all the stockholders pro rata, be-

cause the increased amount of surplus due to the partial exemption from taxation would not have constituted a separate fund, but would have been "converted" into a general stock dividend, along with the rest of the surplus, for the benefit of all the stockholders pro rata.

The truth of this statement may be shown by the following illustration: Suppose the railroad company's stock had been $5,000,000 in $100 shares, the appellees holding 10,000 shares, or $1,000,000 of the capital stock; that the surplus, after deducting the taxes paid thereon, had been $1,000,000 in 1865, $500,000 in 1866, and $500,000 in 1867, and that a 40 per cent stock dividend had then been declared. The appellees' share of this new stock would have been worth $400,000 at par, and according to their theory taxes at 5 per cent to the amount of $20,000 would have previously been paid upon it when it was in the shape of surplus. Had the city's proportion of the surplus not been taxed, however, the net surplus, over taxes, would have been $1,010,000 in 1865, $505,000 in 1866, and $505,000 in 1867, or $2,020,000 for the three years, which would have justified a stock dividend of 40.4 per cent, the appellees' share of which would have been worth $404,000, or only $4,000 more than a 40 per cent dividend would have been worth, the remaining $16,000 going to increase the value of that portion of the stock dividend which was distributed among the other shareholders.

Thus it is seen that, by the appellees' own theory of what constituted the stock dividend of 1867, and of the connection between that stock dividend and the taxes levied on surplus in 1865–1867, the claim allowed and

paid them in 1891 exceeded the benefit that would have accrued to them had what they consider their share of the surplus of 1865–1867 never been taxed at all, the excess being measured by the proportion which the amount of the capital stock held by the other shareholders in 1867 bore to the whole stock. By the appellees' own theory of "surplus dividends" logically worked out they have been paid, under the acts of 1890 and 1891, a large percentage more on account of taxes on "surplus dividends" than they lost by the payment of such taxes—a result which demonstrates both the utter fallacy of the theory and of the contention that the act of 1890 authorized the presentation and consideration of a claim on account of taxes upon any dividends of that protean character.

From whatever point of view the act of 1890 is regarded, therefore, the conclusion is irresistible that in allowing a claim for taxes "on surplus profits which were afterwards set apart * * * as the basis of a stock dividend" the Secretary of the Treasury and the Commissioner of Internal Revenue exceeded their jurisdiction under that act, and that to the extent of $17,712.89 (reduced by the Commissioner in 1893 to $14,385.34) their allowance was without warrant of law.

In the argument in the court below it was contended that the following proviso to section 121 of the act of June 30, 1864 (13 Stats., 284), had some bearing on the case:

> *Provided*, That when any dividend is made which includes any part of the surplus or contingent fund of any bank, trust company, savings institution,

> insurance or railroad company which has been assessed and the duty paid thereon, the amount of duty so paid on that portion of the surplus or contingent fund may be deducted from the duty on such dividend.

The proviso is simply this: that when a dividend is declared which includes any part of a surplus upon which a tax has already been paid the tax paid upon such part of the surplus so included shall be deducted from the tax on the dividend; or, in other words, that a dividend shall only be taxed in so far as it distributes profits which have not themselves been already taxed. What sort of dividend does this proviso refer to? Not to a "dividend in scrip," properly understood, because such a dividend is merely a promise of some dividend *in the future*, or to be paid out of future profits, whereas this proviso relates to prior profits. Clearly the proviso can only refer to a dividend declared in whole or in part out of the hitherto undistributed profits of some former half-yearly period (for these taxes were paid half-yearly) upon which profits the tax levied under section 122 had already been paid, and such a dividend can only be a *cash* dividend, because, as already shown, a "stock dividend," as it is called, really distributes nothing to the stockholders which they did not already possess, so that the status of surplus profits can not be affected thereby.

Conceding, however, that the authorities are wholly wrong, and that, in some mysterious way, the stock dividend of 1868 did "include" surplus profits previously taxed, within the meaning of the proviso, how does that affect the present case? By the appellees' theory the

taxes previously paid on such surplus ought to have been deducted from the tax on the stock dividend and the latter tax diminished to the extent of the deduction. Before there could be any deduction, however, the stock dividend must first have been returned for taxation, which the record does not show to have been done, either in 1867 (when the stock dividend was declared) or in 1868 (when the appellees received their new shares) or at any other time. This stock dividend *never was returned for taxation and never was taxed*, and the proviso in section 121 never operated upon it at all.

Making still another concession, for the sake of argument, and admitting that it was unnecessary for the railroad company to make any return of the stock dividend of 1868, because the deduction that would have been made on account of prior taxes on surplus would have left no tax to be levied upon the stock dividend, so that the stock dividend, though not returned for taxation, should be treated as if a tax had been paid upon it, the fact still remains that such tax was never *deducted* from the stock dividend, for the record shows that the shareholders received the full amount of the new shares issued without any deduction whatever. (Rec., 6–7.) That the taxes should have been deducted was a condition of the right to present the claim under the acts of 1890 and 1893.

A fortiori does the foregoing apply to the stock dividend of 1880. The tax law had been repealed nine years before this stock dividend was declared, so that there could be no pretense of any payment of tax upon it or of any abatement of such tax on account of prior

taxes on surplus, under section 121, or of any deduction from such stock dividend of the amount of any tax levied upon it, which deduction was essential to the Commissioner's jurisdiction under the acts of 1890 and 1893. The stockholders received *that* dividend in full, beyond the possibility of controversy.

In point of fact not only has the proviso in section 121 of the act of 1864 no bearing on the case, but neither the appellees nor either of the two Commissioners of Internal Revenue who allowed the claims ever considered that it had, and the claims presented and allowed were entirely different, both in character and amount, from what they would have been had those parties acted on the theory that this proviso was to be considered. The stock dividend of 1867 was 40 per cent of the amount of stock then held, but the record does not show that the surplus profits amounted to just 40 per cent of the capitalization. The appellees did not apply for a refund of taxes deducted from 40 per cent of the par value of the shares of stock held by them, but they applied for and were allowed a refund of taxes deducted from what they considered to be their proportionate share of the surplus profits of three particular years, without any regard to whether that share amounted to 40 per cent of the par value of their stock or not.

As to the allowance made under the act of 1893 of the taxes paid on surplus in 1868–1871, on the theory that they were deducted from the stock dividends of 1880, it is only necessary to say that there was no more legal authority therefor than for the similar allowance in 1890. As to the allowance of 1893, however, the court

below is in error in saying (Rec., 12) that the appellant has not sought to impeach the award. To the extent of the allowance for taxes on surplus in 1868–1871 (viz, $3,248.51) that award is impeached, on the ground that the act of 1893 authorized no such allowance, as the Court of Claims itself held in the Logan County case. The balance of the award was unimpeachable in itself, in that it was for a valid claim, but the appellant's objection to it is that the whole previous allowance for taxes on surplus should have been deducted from the award by the Commissioner before he reported the final balance.

(2.)

Whether a deduction on account of errors of law in a previous settlement could properly be made in the Treasury Department.

This point applies only to that portion of the Comptroller's deduction which related to the allowance of 1890 for taxes on surplus, as corrected by the Commissioner in 1893, viz, the sum of $14,385.26. (Rec., 11.) The ground on which this deduction was made was that which has just been considered above, viz, that the remedial act of 1890 authorized no such allowance. That a deduction can be made on such a ground as well as for mistake of fact is now well recognized. As this court has recently said:

> As a general rule, and on grounds of public policy, the Government can not be bound by the action of its officers, who must be held to the performance of their duties within the strict limits of their legal authority, where by misconstruction of the law under

which they have assumed to act unauthorized payments are made. (*Whiteside* v. *United States*, 93 U. S., 247; *Hawkins* v. *United States*, 96 U. S., 689, and cases before cited.) The question is not presented as between the Government and its officer or between the officer and the recipient of such payments, but as between the Government and the recipient, and is then a question whether the latter can be allowed to retain the fruits of actions not authorized by law resulting from an erroneous conclusion by the agent of the Government as to the legal effect of the particular statutory law under or in reference to which he is proceeding. * * * If in his [the Postmaster-General's] judgment money has been paid without authority of law, and he has money of the same claimant in his hands, he is not compelled to pay such money over and sue to recover the illegal payments, but may hold it subject to the decision of the court when the claimant sues. * * * And in that way multiplicity of suits and circuity of action are avoided. (*Wisconsin Central R. R.* v. *United States*, 164 U. S., 190, 210.)

The above doctrine clearly applies to the present case, although it goes even further, involving apparently even the right to reopen former settlements in certain cases. That right is not involved in the present case, as the settlement was not reopened by either the Commissioner or the Comptroller of his own motion, but at the instance of the appellees, by authority of the statute.

(3.)

Whether the Comptroller could properly make a deduction from such an award as was made in this case.

The Court of Claims has answered this question in the affirmative in the Logan County case as to the deduction

of an allowance first made in 1893 for taxes on surplus, and as regards the mere question of the Comptroller's authority to act, it can make no possible difference that a part of the allowance which he caused to be deducted in the present case was made in 1891. If he had power to act as to the later allowance, he had the same power as to the first, unless the two stood on different grounds, which has been shown not to have been the case.

The award came to the Comptroller's Office through the Fifth Auditor in the regular way, because it was a claim for a refund of internal-revenue taxes alleged to have been illegally collected, a claim which ought to have been presented under section 44 of the tax law of 1864, as amended in 1866, now in force as section 3220 of the Revised Statutes. Not having been presented in time, its presentation was made possible by the act of 1893, but the delay did not change the nature of the claim, and that act expressly declared that section 3220 of the Revised Statutes was "hereby made applicable and available with the force and effect as if protest and demand for payment had been made within the time prescribed" thereby. It is well known that the regular practice of the Treasury was that all claims allowed in whole or in part by the Commissioner under section 3220 went to the Fifth Auditor under section 277, and from him to the First Comptroller under section 269, and there being nothing in the act of 1893 to deprive the Comptroller of his jurisdiction over the claim, Congress must be presumed to have intended that the regular course should be followed and that the Comptroller should

have the same jurisdiction over the claim whenever it should come to him as he would have had had it been presented under section 3220.

The Commissioner's decisions, under section 3220, are in the nature of awards by arbitrators, not to be impeached nor subject to review by the Comptroller for a mistake of judgment or discretion, but impeachable for fraud, *want of jurisdiction*, patent mistake, or other like irregularities. (*Bank of Greencastle* v. *United States*, 15 C. Cls. R., 225; *Nixon* v. *Same*, 18 id., 448, 454; *Ridgway* v. *Same*, id., 707; *Sybrandt* v. *Same*, 19 id., 461; *Frerichs* v. *Same*, 21 id., 16; see also *McKnight* v. *Same*, 13 id., 292, 309.)

Now, the *jurisdiction* to allow a claim on account of taxes on surplus was precisely what the Commissioner lacked under the act of 1893, which only gave him jurisdiction over claims on account of taxes "deducted from any dividends or interest due and payable," and hence his allowance of $3,248.55 on account of taxes on surplus for 1868–1871 was an illegal assumption of jurisdiction, and it was the Comptroller's duty, as well as within his power, to correct the error by deducting the amount erroneously allowed. (*Seat* v. *United States*, 18 C. Cls. R., 458.)

It is equally beyond question that when the Comptroller deducted from the allowance of 1893 so much of what had been paid in 1891 as the Commissioner had not himself already deducted, the former did not reopen the settlement of 1891. When the allowance of 1893 came before him, that settlement, as has been shown above, had

already been reopened, and the allowance then made, merged in that of 1893, so that the claims of 1891 and 1893 had practically become a single claim, upon which there had been a payment on account. The question of the Commissioner's jurisdiction to allow a claim for taxes on surplus therefore came before the Comptroller as properly, in regard to those claims for taxes on surplus which had been allowed in 1891 and paid, as in regard to those which had been rejected in 1891 but subsequently reconsidered and allowed in 1893, and the Commissioner having been equally without such jurisdiction on both occasions, the Comptroller's action was equally proper as to both allowances.

The case of *United States* v. *Kaufman* (96 U. S., 567) and *United States* v. *Savings Bank* (104 U. S., 728) furnish no argument against the authority of the Comptroller in cases of this sort; they merely confine his authority within its proper limits. The question in those cases was whether or not the Court of Claims had jurisdiction after the Comptroller had decided the matter, and it was held that it had. In the Kaufman case it was also held that until the decision of the Commissioner of Internal Revenue in favor of a claim was impeached in some appropriate form, the liability of the Government was conclusive; that is to say, that the mere fact of a disallowance by the Comptroller did not shift the burden of proof, and that "the affirmative of the impeachment [was still] upon the Government."

In both of those cases the court concurred in the views of the Commissioner, not in those of the Comptroller;

but in the Savings Bank case the court below, whose decision was affirmed, was most careful not to limit the Comptroller's authority further than to say that his refusal to authorize the payment of a claim "does not finally settle the legal rights of the claimant," adding the significant words, "It is his duty to refuse to pass a claim which he considers unjust and impeachable in law, and thus to leave the claimant to his remedy in the proper court." (16 C. Cls. R., 352.)

It appears, therefore, that both of the allowances for taxes on surplus earnings of the railroad company were illegally made, and hence that the first one (that of 1891) could properly be deducted from any new allowance subsequently made, while the second (that of 1893) could be stopped at any time before actual payment, and it further appears that the Comptroller had power to act in the matter. Hence, whether the payment of 1891 be held to be of the same character as ordinary Treasury payments, or whether the act of 1893 be held to have specially authorized a reopening, on the appellee's motion, of the settlement of 1891, in either event the Comptroller's action in deducting from the award of 1893 the net illegal allowance of 1891, as well as the illegal allowance of 1893, was correct, and it is submitted that the judgment of the court below be reversed.

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